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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-92

ABRAHAM COHEN and ESTHER FRIEDLANDER, Co-Executors of the Last Will of Raphael Cohen, Deceased,

Petitioners,

v.

FRANCHARD CORPORATION, LOUIS A. SIEGEL and SEYMOUR YOUNG,

Respondents,

and

JOSEPH E. LOW, GLICKMAN CORPORATION OF NEVADA and WEDGWOOD HOUSE ASSOCIATES,

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Statement

Petitioners, Abraham Cohen and Esther Friedlander pray that a Writ of Certiorari issue to review a judgment entered by the United States Court of Appeals for the Second Circuit on April 11, 1973.

The Court of Appeals affirmed a judgment entered on a jury verdict in the United States District Court for the Southern District of New York (Hon. Lloyd F. MacMahon).

The opinion of the Court of Appeals is reprinted as Appendix A and is not reported officially, yet.

The District Court's charge insofar as is pertinent is reprinted as Appendix B.

Jurisdiction

The judgment of the Court of Appeals was dated and entered on April 11, 1973. Petitioners did not seek rehearing in the Court below. The jurisdiction of this Court to issue a Writ of Certiorari to the Court of Appeals is invoked under 28 U.S.C. Section 1254(1).

Questions Presented

This class action was brought on behalf of purchasers of units of a real estate limited partnership syndication. The syndication offered such units pursuant to an offering brochure ("Prospectus"). The Prospectus did not have to be, and was not, filed with the Securities and Exchange Commission ("Commission").

Although the complaint alleged several violations of the securities laws, as finally submitted to the jury by consent of counsel, it contained only alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Section 352(b) of the New York State General Business Law.

The Prospectus, aimed at the elderly, retired and generally unsophisticated investor with small resources, was alleged by petitioners to be false and fraudulent.

The fraud was based upon express misstatements and failure to include material facts.

The evidence was contested. Petitioners produced proof of the fraud and respondents denied specific knowledge of the alleged omissions, asserting that they had no knowledge of omissions or fraud. The respondents conceded that they had conducted no investigation into the representations contained in the Prospectus and had not disclosed to the public their non-investigation.

The Circuit Court affirmed the District Court's charge to the Jury that for the class to recover plaintiffs had to prove:

1. "Guilty knowledge is the key to your decision in this case. The plaintiffs must establish that the defendant whom you are considering had knowledge and intended to defraud these plaintiffs, or that he acted in reckless disregard for the truth, or that he knowingly used a device, scheme or artifice to defraud."

2. ". . . the plaintiffs relied on untrue or misstatements of material facts. The test for determining whether or not a plaintiff relied on an alleged misrepresentation or an omission is whether the misrepresentation or omitted fact was a substantial factor in plaintiff making a choice as to whether or not to buy a limited partnership unit in Wedgwood House Associates, or whether the plaintiff acted because of some other reason. You should ask yourself, how many of these prospective buyers actually read the documents? Did they rely on the statements. In order to be influenced by the representation, the plaintiff must, of course, have relied upon it, must have read it, he must have relied upon it and he must have believed it to be true. If it appears that he knew the facts or that he believed the statements to be false, or that he reposed in confidence in it, the false statement cannot be regarded as a substantial

cause in making his decision whether or not to buy a unit. The representation must have had a material influence upon the plaintiff's action and be a substantial factor in bringing about what he does.

"In this connection, you will recall that there was some evidence to the effect that the plaintiff here, Raphael Cohen, purchased units in Wedgwood House long after the facts underlying the complaints made here became general knowledge, and were fully exposed, and you should consider that fact along with the other evidence as to whether the plaintiffs relied on any statements contained in the brochures and the prospectuses."

The questions presented involve important substantive and procedural questions of broad and national impact. These are:

1. Must offerors of securities to the public, owing fiduciary duties to the purchasers of the securities, be shown to have had actual knowledge of the falsity of the offering prospectus circulated under their names to be held liable under Section 10(b) of the 1934 Act?

2. Can offerors of securities to the public owing fiduciary duties to the purchasers of the securities, avoid liability under Section 10(b) of the 1934 Act, by making no investigation into the facts presented or implied in the offering prospectus circulated under their names?

3. Must the class prove actual reliance upon an alleged false and fraudulent prospectus which contained omissions of facts?

4. Was the Circuit Court's refusal to reverse the errors in the District Court's charge on reliance justified by the "plain error rule" or Rule 61 FRCP?

The questions presented above, involve substantive issues of paramount importance to the investing public and to the securities business nationally. These questions have been the subject of numerous conflicting decisions among the various Circuits and within the Second Circuit. The decisions have even conflicted with two recent decisions of this Court. Public sales and purchases of securities grow with increasing frequency and litigations presenting the issues also abound. The issues need to be resolved by a definitive ruling and the various conflicts put to rest finally, in order that parties may act with full knowledge of their responsibilities and obligations.

Statutes Involved

The statutes involved are 15 U.S.C. § 78j(b) (1970) (Section 10(b) of the Securities Exchange Act of 1934), Rule 10b-5 promulgated thereunder by the Commission, 17 C.F.R. § 240, 10b.5 (1972); Section 352 of the N.Y. General Business Law (McKinney 1968) and Rules 51 and 61 Federal Rules of Civil Procedure.

The Facts

A. The Background.

The originator of the syndication in question was one, Louis Glickman (who is not named as a defendant). He was a well-known real estate syndicator, being responsible for the creation of the many Glickman enterprises. He was founder and first President of the Association of Real Estate Syndicators, Inc. He was also President and Chairman of the Board of Franchard Corporation.

At the time in question, the Glickman syndication practice consisted of acquiring through option, contract or purchase by the Glickman corporation or companies of particular real estate, subsequently organizing a limited

partnership and the sale to the public of interests therein for cash. The cash received from such sales was used to acquire the real estate for the limited partnership.

The general partners of this limited partnership would be Mr. Glickman and two or three of his nominees—usually other officers of his organization.

The property syndicated would then be leased for operation to one of the Glickman entities with rent to be paid to the limited partnership and monthly distribution to the investors in the range of 10%-11%. The offerings of interests in the limited partnerships made to the public, were made pursuant to brochures, which extolled the virtues of investing in the particular partnership, rosy projections of the potential success of the particular property and the virtues of investing in the Glickman organization. The Securities Exchange Commission subsequently criticized the Glickman brochures for, *inter alia,* their failure to outline to the public the grave risks of each of the syndication offerings (*Matter of Franchard Corporation,* CCH Fed. Sec. L.Rep. ¶ 77,113; Sec. Act, Rel. No. 4710 July 31, 1964). See also, *Lerman* v. *Tenney,* 295 F.Supp. 780, 783 (S.D.N.Y. 1969).

B. The Transaction in Litigation.

The syndication in this litigation followed the Glickman general practice.

The parties involved in the syndication offering were the following:

Franchard Corporation ("Franchard"), a New York corporation, was organized in 1960 for the purpose of becoming a public company and taking over the ownership and operation of many properties previously owned and/or operated by the Glickman organization, together with various syndications formed by that organization. It was orig-

inally organized under the name of Glickman Corporation of America; in 1963, after the difficulties described herein surfaced, the name was changed to Franchard.

The takeover was accomplished by the various Glickman entities, exchanging their holdings and assets for stock in Franchard. Additional Franchard stock was sold to the public. Glickman, himself, received substantial amounts of stock of Franchard and thereby became one of the principal shareholders, as well as its President and Chairman of the Board. Respondents Siegel and Young who also had ownership interests in various syndications exchanged those interests and received stock of Franchard.

Wedgwood House Associates ("Associates") was the limited partnership syndication involved in this litigation. It was organized under New York Law to acquire ownership of the two New York City properties: Wedgwood House, a residential apartment building on Fifth Avenue, then almost being completed, and land on 34th Street and Third Avenue, upon which was to be built Warren House, another apartment building. Associates was to build Warren House. Mr. Glickman, together with respondents Siegel and Young, were the general partners in Associates.

Messrs. Siegel and Young were also Senior Vice President and Vice President, respectively, Directors and significant shareholders of Franchard. They had been participants with Mr. Glickman in a number of other of his syndications, receiving substantial benefits therefrom. They were also officers and directors of Glickman Corporation of Nevada ("Venada"), a Nevada corporation, wholly owned by Glickman. It, too, changed its name after the difficulties began. This corporation was the net lessee of both Wedgwood and Warren Houses under the syndication described.

The Transaction

In October 1960, when the concept of syndicating the Wedgwood and Warren Houses was originated, Venada entered into the contract of purchase. Associates was organized as a limited partnership under New York law to acquire the contract of purchase which Venada was to assign. The total price needed for the assumption of the purchase price, construction of all buildings, the miscellaneous expense required for the transaction and to realize a profit for the originators was $6,645,000. Associates' three general partners (Messrs. Glickman, Siegel and Young) and the original limited partner, Joseph Low,* contributed $105,000 for their general and limited partnership units. The balance of $6,545,000 was to be obtained from the public through the sale of limited partnership units.

Two sets of multicolor flyers and prospectuses were issued, one in October 1960, and an even more elaborate one in January 1961.**

The prospectuses were not required to be filed with the Commission, and, hence, they were unrestrained in their selling inducements. They proclaimed that the offering was a "New Real Estate Syndication Offering," and that the investor would have tax shelter, higher income, growing equity diversification, inflation hedge, prestige ownership and professional managership. The investors were promised that they would receive an 11% per annum re-

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* Joseph Low was originally named as a defendant in this action, but was dropped by consent of the parties after the case was submitted to the jury.

** The January 1961 prospectus was occasioned by the enactment of Section 352(e) of New York General Business Law which required that certain specified information be filed with the State Attorney General and that all advertising in connection with the offering be consistent with the filing with the Attorney General.

turn on the investment, and this would be paid in monthly checks.

The prospectuses claimed that the Glickman organization stood behind the venture. Indeed, the January 1, 1961 prospectus stated, "When you invest your money in real estate syndication, the Glickman way, you invest with one of the largest and most prominent syndication organizations in America." Pictures of 11 earlier syndicates were included. These syndications were part of the Franchard assets since its public issue and exchange of October 1960.

The public was further informed that the Glickman Organization had made syndication distributions of more than $10,000,000 in the last six years alone.

In short, the prospective investor was assured that his investment would be risk-free.*

The prospectus elaborately described the two properties, the building construction, the architects, the lessee (Venada —a Glickman entity) and assured the public that the Glickman organization, and expert staff people stood behind the venture.

The prospectus indicated the income to be received, the proposed expenses and the expected profit and the excess over expenses which would be a protective cushion to insure the investor receiving his promised 11% return.

The investors were informed of the mortgages existing on the property, the possible increases in their equity if these mortgages were to be paid off.

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* On the back cover or last page of the prospectus, in virtually the last paragraph and in the smallest print—and preceded by the comment that all of the "statements, representations, statistics, data, estimate and projections are . . . believed to be reliable," appeared the comment that "All statements, provisions and other material. . . . which relate to future transactions or happenings are, of course, subject to and contingent upon presently unforeseeable developments."

Finally, the prospectuses described the general partners in laudatory terms. It also noted that Venada could assign the leases but if such assignment took place, it guaranteed performance for a period of three years.

The investors were not told that the ventures were risky; no information was given as to the financial strength of Venada or Glickman—the lease operators, and no investigation had in fact been made into the financial strength of Venada or Glickman; indeed, the investor was not told that the two general partners—Messrs. Siegel and Young—who had conducted no investigation, had previously invested with Mr. Glickman and were dependent upon his largesse. The investor was not told that Venada could mortgage its operating lease.

The failure of Messrs. Siegel and Young and Franchard to make any attempt to ascertain the financial status of either Venada or Glickman was inexcusable. They would have encountered no difficulty in that investigation. Venada, the prospective lessee had no employees of its own. It conducted its business from the Franchard offices. All personnel doing Venada work were employed and paid by Franchard. Messrs. Siegel and Young were officers and directors of Venada and had authority to sign checks for Venada. Bernard Mann, the Treasurer and Assistant Secretary of Franchard, was also the Treasurer of Venada.

Messrs. Siegel and Young had a substantial self-interest (undisclosed to the public) in not investigating. Both had received and were receiving substantial compensation from Franchard—presumably at the instigation and approval of Mr. Glickman. Each had just received stock and bonuses shortly before the syndication in question. Both were general partners in other Glickman syndications receiving their units without payment. These units were then exchanged for Franchard stock.

Apart from the proof submited by petitioners demonstrating the fraud with respect to the stated representa-

tions concerning income and expenses which respondents contested, one area of fraud remained undisputed. There was no financial stability in the syndication. Venada had already defaulted in the amount of $296,329 in the rent payments from October 1960 to December 1960 in three other Glickman syndications at the time of the offering in question. Franchard and/or Siegel and Young had interests in those three other syndications.

Mr. Glickman had begun to "borrow" Franchard's funds to cover the obligation of Venada as well as his own personal obligations. Franchard was at times partially and at other times wholly repaid and a new cycle of borrowings always ensued.

In the syndication at bar, Venada defaulted on the very first rent payment due and while Associate's securities were still being offered under the January 1, 1961 prospectus. Franchard advanced the funds for this rent payment, as well. The cycle of borrowings necessary to bail out Venada and Mr. Glickman, personally, accelerated through 1961 and 1962 resulting in amounts owed to Franchard exceeding $600,000. At the time of Associate's offering, Venada had a substantial capital deficiency totaling $1,726,000.

Prior to the closing of Associate's syndication, Mr. Glickman had pledged his vast stock holdings in Franchard, as well as the stock owned by his family and his other entities to secure his defaulted loans. Venada had (without the knowledge of the limited partners and without disclosure of same in the prospectus) placed a second mortgage on Wedgwood and Warren Houses. Although it was represented that the proceeds of the offering would be kept in a separate trust fund for construction purposes, the funds were not segregated and were used by Venada and Glickman in their financial difficulties. As a consequence, the various contractors and builders were not paid and numerous liens were placed upon the properties. Mr.

Glickman and Venada filed petitions under Chapter XI in February 1963, Venada was evicted as net lessee in March 1963 and Mr. Glickman was "removed" as active general partner.

The Franchard checks used for the various loans to Venada, were signed by Bernard Mann, and Messrs. Siegel and Young testified that they may have signed some of the checks.

The Litigation

The action was tried before a Jury. The issue of liability was tried first and the Court rendered the charges (among others) described above. The Jury found for the defendants.

The Circuit Court affirmed unanimously. It concluded, in line with certain of its decisions "that a party cannot be held liable in a private suit for damages under Rule 10(b)-5 for mere negligent conduct . . . Although it is unnecessary to prove this specific fraudulent intent essential to a claim of common law, it must be established that the defendant was to some extent cognizant of the misstatement or omission." The Court went on to hold that the standard for liability under Rule 10(b)-5 is "that defendant either knew the material facts that were misstated or omitted . . . or failed or refused to ascertain and disclose such facts when they were readily available to him and he had reasonable grounds to believe that they existed."

The Circuit Court found that with respect to reliance that they could review this aspect of the charge under their doctrine of "plain error." The Court concluded that the actual reliance charge stated by the District Court was consistent with its own prior holdings and refused to adhere to this Court's prior decisions because their "full implication . . . have not yet been determined." In any event, they concluded that petitioners' trial counsel had

failed to object to the charge and can be deemed to have acquiesced in it.

We respectfully disagree and submit that both of the issues were wrongfully decided and are of such importance as to require review in this Court.

Reasons for Granting the Writ

I

The decision conflicts with decisions of other circuits as well as decisions of this court.

A. The affirmance by the Second Circuit of the District Court's charge conflicts with the decisions of other Circuits respecting Section 10(b).

The Second Circuit holds that "A party cannot be held liable in a private suit for damages under Rule 10(b)-5 for mere negligent conduct." This decision reiterates other decisions of a similar vein.

See e.g.

Chris-Craft Industries, Inc. v. *Piper Aircraft Corp.*, CCH Sec. L. Rep., § 93,816 (2nd Cir. March 16, 1973) not officially reported yet.

Lanza v. *Drexel & Co.*, CCH Fed. Sec. L.Rep., § 93,959 (2nd Cir., April 26, 1973)* not officially reported yet

The result is in conflict with other Circuits which have sustained 10(b) liability for negligence or lack of diligence.

See e.g.

Mitchell v. *Texas Gulf Sulphur*, 446 F.2d 90 (10th Cir. 1971);

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*A divided *en banc Court*.

Gilbert v. *Nixon*, 429 F.2d 348 (10th Cir. 1970);
Stevens v. *Vowell*, 343 F.2d 374 (10th Cir. 1965);
Royal Air Properties, Inc. v. *Smith*, 312 F.2d 210, 212 (9th Cir. 1962);
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City National Bank of Fort Smith, Arkansas v. *Vanderboom*, 422 F.2d 221, 229 (8th Cir. 1970) cert. den. 399 U.S. 905 (1970);
Kohler v. *Kohler Co.*, 319 F.2d 634 (7th Cir. 1963);
Gould v. *American Hawaiian Steamship Co.*, 319 F. Supp. 795, 801 (D. Del. 1970).

The conflict caused by the Circuits' different interpretations of 10(b) and the standards of liability are the subject of recurring consideration. Indeed, there has recently been filed in this Court a petition for certiorari to the Fifth Circuit, presenting such conflict for resolution. See, e.g., *H. Hence & Co.* v. *Kasner*, Doc. No. 72-1533, filed May 14, 1973.

We submit that logic and justice requires that, where, as here, fiduciary relationships are involved, mere negligence or lack of diligence is covered by Section 10(b).

This Court held, in *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963), that the purpose of the 1934 Act was to impose "a philosophy of full disclosures for the philosophy of caveat emptor and thus to acknowledge a high standard of public ethics in the securities industry." This Court further stated, at page 195, that the legislation was to be construed "not technically and restrictively, but flexibly, to effectuate its remedial purposes."

That view was reaffirmed respecting fiduciary relationships in *Superintendent of Insurance of State of New York*

v. *Bankers Life and Casualty Company*, 404 U.S. 612, 92 Sup. Ct. 165 (1971):

> "The Congress made clear that 'disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web, along with manipuation, investor's ignorance, and the like. H. R. Rep.No. 1383, 73d Cong. 2d Sess. p. 6." (92 Sup. Ct. 165, 168-169).

The decision below creates a dangerous rule in securities law and in the requirement of full disclosure. It enables a fiduciary to sit supinely by allowing representations to be made on his behalf to the public without any investigation by him as to their truth or falsity. Such a rule allows a fiduciary and others to permit their names and reputations to be actively used in public offerings adding to the claims of integrity and solidness of the proposed investment when the fiduciary has done nothing to verify such claims and the failure to make such investigation has not been disclosed. Since the fiduciary escapes civil liability by non-investigation under the decision below, there would be every incentive not to make full investigation and disclosure thus increasing the dangers to the uninformed laymen public.

The rule suggested by the opinion below creates a dangerous gap in the scheme of enforcing the requirement that signatories to public offerings make investigation or at least disclose their failures so to do.

Managed Funds Incorporated, 39 S.E.C. 313, 320-1;
National Invested Savings Corp., 1 S.E.C. 825, 829-30.

By like token the Commission has obtained injunctions based on failure or negligence of insiders to exercise due diligence with respect to information disclosed or not disclosed to the public.

S.E.C. v. *Texas Gulf Sulphur Co., supra.*

In such matters, by the time the Commission acts administratively or in the courts, the public will have been monetarily damaged. Unless the public has the same standards to recover as the Commission has, the public will be unable to obtain monetary redress. In short, the insider will be allowed to keep ill-gotten gains and be punished only by administrative and injunctive sanctions, with the public still "out of pocket." No monetary redress will be obtained through the Courts and the Commission will have already determined that defendants acted improperly.

Moreover, the decision below impedes the private right of suit, recognized as an important weapon in the arsenal of enforcement where the Commission cannot prosecute for lack of resources or where the offering was not subject to registration.

Analogous situations also suggest that guilty knowledge should not be required. See, for example the construction of Section 14(a) of the 1934 Act and Rule 14a-9(a) enacted thereunder which holds that mere negligence is enough for liability under that section.

> *Gerstle* v. *Gamble-Skogmo, Inc.*, CCH Fed. Sec. L. Rep., § 93,983 (2nd Cir., May 9, 1973) not reported officially yet.

It should be noted that nothing in either Section 10(b) or 10(b)-5 suggest guilty knowledge as an element of any claim thereunder. If Congress or the Commission desired such element, they could have so provided.

> See, e.g., *Ellis* v. *Carter, supra.*

The rule we urge finds its counterpart in state law. See:

> *Doyle* v. *Chatham & Phenix National Bank*, 253 N.Y. 369; rearg. den. 254 N.Y. 548 (1930);

International Products Company v. *Erie R. Co.*, 244 N.Y. 331 (1927), *cert. den.* 275 U.S. 527 (1927);

Skrine v. *Staiman*, 30 A.D.2d 707 (2d Dept., 1968), *aff'd.* 23 N.Y.2d 946 (1969);

First National Bank of Hempstead v. *Level Club*, 241 App. Div. 433 (1st Dept., 1934);

Abel v. *Paterno*, 245 App. Div. 285 (1st Dept., 1935).

B. The decision below materially varies from this Court's prior decisions. Indeed, the decision below frustrates the statutory policy of enforcement through private litigation.

This Court held in *Mills* v. *Electric Auto-Lite Company*, 396 U.S. 375 (1970) and *Affiliated Ute Citizens* v. *The United States*, 406 U.S. 128, 92 S.Ct. 1456 (1972) that it was unnecessary to prove actual reliance.

In *Affiliated Ute Citizens, infra*, a case involving, as here, fiduciary relations, this Court held:

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." (92 S.Ct. 1456, 1472)

The Circuit Court refused to apply the foregoing because "the full implications of these decisions have not yet been determined."

We submit that the language and intent of this Court is plain and it required the Circuit Court not to insist upon an affirmative finding of actual reliance.

The decision below, moreover, conflicts with Rule 23 of the Federal Rules of Civil Procedure. This action was, after all, a class action.

It is well settled that the problem of reliance in class actions is an individual question which is tried after the common or class questions are tried—presumably at a time when the individual members of the class make claims to the fund.

Green v. *Wolf Corporation*, 406 F.2d 291 (2nd Cir. 1968), *cert. den.* 395 U.S. 977 (1969);
Harris v. *Palm Springs Alpine Estates, Inc.*, 329 F.2d 909 (9th Cir. 1964);
Hawk Industries Inc. v. *Bausch & Lomb, Inc.*, CCH Fed. Sec. L. Rep. § 93,997 (S.D.N.Y. May 18, 1973) not officially reported yet;
Fischer & Kletz, 41 F.R.D. 377 (S.D.N.Y. 1966);
Mersay v. *First Republic Corporation of America*, 43 F.R.D. 465 (S.D.N.Y. 1968);
Victorian Investors Corp., et al. v. *Responsive Environments*, CCH Fed. Sec. L. Rep. ¶ 93,661 (S.D.N.Y. November 1, 1972); not officially reported;
Wolfson v. *Solomon*, CCH Fed. Sec. L. Rep. ¶ 93,343 (S.D.N.Y. January 19, 1972).

The decision below destroys these well established authorities and instead, places insurmountable objections to the maintenance of a class action. It would result in either having all of the members of a class present to testify to reliance, delaying the trial beyond human endurance or having the members of a class bound by what the conduct of one or two of those who do testify, would be. No such result was intended under Rule 23 and the cases construing same. Thus, the opinion effectively destroys class actions.*

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* At bar, there were written documents submitted which expressly stated that the purchaser of the limited partnership units relied on the prospectus.

II

The Circuit's refusal to review the reliance charge as not warranted under the plain error rule is erroneous.

The Circuit Court, basing its result upon the fact that petitioners' trial counsel had failed to object to the reliance charge, refused to reverse because of the erroneous reliance charge. It held that petitioners had not demonstrated "that a substantial miscarriage of justice has occurred." The Circuit Court did concede that the erroneous charge related "to important elements in appellant's case" but that the rule did not require reversal even where the error was "on a significant aspect of the case."

As we have shown in I *supra*, the charge with respect to reliance rested on a fundamental misreading of this Court's prior decisions. The Second Circuit's decision herein, in refusing to review that charge places itself at odds with other Circuit Courts which, under the same "plan error" rule, have reviewed and reversed as to erroneous charges.

> See e.g. *Ratay* v. *Lincoln Life Insurance Company*, 378 F.2d 209 (3rd Cir. 1967), *cert. den.* 389 U.S. 973 (1968);
> *Mondshine* v. *Short*, 196 F.2d 606 (5th Cir. (1952);
> *Shokuwan Shimabukuro* v. *Hideyoshi Nagayama*, 140 F.2d 13 (C.A.D.C. 1944) *cert. den.* 322 U.S. 755 (1944).

Indeed, the Circuit Court's decision is at variance with its prior decision in *Ferrara* v. *Sheraton McAlpin Corporation*, 311 F.2d 294 (2d Cir. 1962).

This Court has held that if the charge is erroneous, it is presumptively prejudicial.

> *McCandless* v. *United States*, 298 U.S. 342, 347-8 (1936);
> *Fillipon* v. *Albion Vein Slate Co.*, 250 U.S. 76, 82 (1919).

As we have shown in *I supra*, the charge dealt with an integral and basic element of petitioners' case. The charge stated a fundamental proposition of law which was at variance with the law already established by this Court irrespective of whether petitioners' counsel had acquiesced in the ruling; we submit that erroneous propositions of law cannot be submitted to the jury and that when it is done, the application of the "plain error" rule must call for review of the charge.

Indeed, if unreviewed, the Second Circuit's decision leaves unsettled the procedural area when, in the absence of objections, fundamental errors can be reviewed. Thus, this Court should, we submit put to rest the question. In this connection, we may note that Rule 61 of the Federal Rules of Civil Procedure requires a Court to "disregard any error or defect in the proceedings which does not affect the substantial rights of the parties." The Circuit Court's ruling ignores this admonition in order to achieve a result which varies from the controlling decision of this Court.

Conclusion

Petitioners respectfully submit that the substantial questions of substantive law under the securities laws and the procedural questions call for review by this Court and require that this petition for a Writ of Certiorari be granted.

Respectfully submitted,

EUGENE J. MORRIS
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Of Counsel

Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 359—September Term, 1972.

(Argued January 17, 1973 Decided April 11, 1973.)

Docket No. 72-1724

ABRAHAM COHEN and ESTHER FRIEDLANDER, Co-Executors of the Last Will of Raphael Cohen, Deceased,

Plaintiffs-Appellants,

v.

FRANCHARD CORPORATION, LOUIS A. SIEGEL and SEYMOUR YOUNG,

Defendants-Appellees,

and

JOSEPH E. LOW, GLICKMAN CORPORATION OF NEVADA and WEDGWOOD HOUSE ASSOCIATES,

Defendants.

Before:

FRIENDLY, *Chief Judge,*
and OAKES and TIMBERS, *Circuit Judges.*

Appeal from a judgment entered on a jury verdict in the Southern District of New York, Lloyd F. MacMahon, *District Judge,* in favor of defendants Franchard Corporation, Louis A. Siegel and Seymour Young on the issue of liability in a class action brought to recover damages for alleged violations of Section 10(b) of the Secu-

rities Exchange Act of 1934, 15 U.S.C. §78j(b)(1970), of Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5 (1972), and of Section 352 of the N. Y. General Business Law (McKinney 1968).

Affirmed.

IRVING BIZAR, New York, N.Y. (Ira Jay Sands, Barbara P. Sugarman and Demov, Morris, Levin & Shein, New York, N.Y., on the brief), *for Plaintiffs-Appellants.*

ROY L. REARDON, New York, N.Y. (Peter J. Schlesinger and Simpson Thacher & Bartlett, New York, N.Y., on the brief), for *Defendant-Appellee Franchard Corporation.*

IRVING PARKER, New York, N.Y. (I. Michael Bayda and Jacobs Persinger and Parker, New York, N.Y., on the brief), *for Defendants-Appellees Louis A. Siegel and Seymour Young.*

TIMBERS, *Circuit Judge:*

This is a striking example of a case that never should have been claimed for jury trial, as plaintiffs' counsel did. That, coupled with what appears to have been a lack of preparation in addition to visibly inept trial conduct on the part of plaintiffs' counsel, is about all that distinguishes this from what otherwise would be an uncomplicated appeal.

We cannot emphasize too strongly our disapproval of the dubious judgment of counsel in claiming for jury trial a case involving such issues as "scienter" and "reliance" under the antifraud provisions of the federal securities laws. It is one thing to try such cases before our district

judges who have become knowledgeable and experienced in dealing with such difficult problems. But it is quite another thing to expect a jury to comprehend such issues, even assuming an utterly perfect charge.

Plaintiffs, representing a class of purchasers of shares in a limited partnership, appeal from a judgment entered on a jury verdict in the Southern District of New York, Lloyd F. MacMahon, *District Judge,* in favor of defendants Franchard Corporation, Louis A. Siegel and Seymour Young on the issue of liability in a class action brought to recover damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1970), of Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5 (1972), and of Section 352 of the N. Y. General Business Law (McKinney 1968).

The chief issue raised on appeal is the propriety of the trial judge's charge to the jury. Subordinate issues are raised with respect to the judge's conduct of the trial.

We affirm.

I.

Events Leading to Instant Litigation

Louis Glickman is a well known real estate syndicator. He was responsible for the creation of the many Glickman enterprises and was founder and first president of the Association of Real Estate Syndicators, Inc. Although not named as a defendant in the instant action, he was involved in the syndicate which is at the center of this action.

Franchard Corporation (Franchard) is a New York corporation. It was organized in 1960 for the purpose of taking over the ownership and operation of many properties previously owned and operated by entities in the Glickman organization, as well as real estate syndicates

formed by the Glickman organization. It was known as the Glickman Corporation until 1963. The takeover by Franchard was accomplished by the various Glickman enterprises exchanging their holdings and assets for stock in Franchard. Additional Franchard stock was sold to the public. Glickman himself became a principal stockholder, president, and director of Franchard.

Wedgwood House Associates (Associates) is a limited partnership syndicate organized under New York law to acquire ownership of two New York City properties—Wedgwood House, a residential apartment building on Fifth Avenue, and land on 34th Street upon which was to be built Warren House, another apartment building. Associates also was to build Warren House.

Glickman Corporation of Nevada (Venada) is a Nevada corporation wholly owned by Glickman. It became the net lessee of both Wedgwood and Warren Houses.

Louis A. Siegel and Seymour Young, together with Glickman, were the general partners in Associates. Siegel and Young also were senior vice president and vice president, respectively directors and shareholders of Franchard. They also were officers and directors of Venada.

In October 1960, Glickman conceived the idea of syndicating the purchase of Wedgwood House and Warren House. At that time Wedgwood House had almost been completed. The construction of Warren House had not yet begun, the land on which it was to be built not even having been cleared of existing structures. Venada entered into a contract for the purchase of Wedgwood House and the land on which Warren House was to be built. A limited partnership, Associates, was then formed. See N. Y. Partnership Law, Art. 8, §90 et seq. (McKinney 1948). It consisted of three general partners—Glickman, Siegel, and

Young—and an original limited partner, Joseph E. Low.[1] Glickman subscribed to 17 general partnership units, Siegel and Young each subscribed to 1½ general partnership units, and Low subscribed to one limited partnership unit. Each unit represented a capital contribution of $5,000. Thus, the total capital contribution of Glickman, Siegel, Young and Low was $105,000.

In order to raise the additional $6,645,000 necessary to assume the Venada purchase contract, to construct the buildings, and to pay all expenses connected with the acquisition and formation of Associates itself, Associates offered to the public units and half-units of limited partnership interests at $5,000 and $2,500 per unit, respectively.[2] The general partners, together with various experts such as architects, engineers, and attorneys, prepared literature to promote the sale of the limited partnership interests in Associates. A flyer and a brochure served as the selling documents from October 1960 to December 31, 1960.

On January 1, 1961, Section 352-e of the New York General Business Law became effective. Section 352-e required that, before an offering concerning the syndication of real estate could be made to the public, a "prospectus" or "offering statement" must be filed with the state Attorney General containing specified information. N.Y. Gen. Bus. Law §352-e(1)(a),(b) (McKinney 1968). It also required that all advertising in connection with the offering be consistent with the information set forth in the prospectus and that all advertising literature be filed with the Attorney General prior to dissemination. Section 352-e(1)(c),

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1 Low originally was named as a defendant in this action. At the close of plaintiffs' case, however, plaintiffs consented to a dismissal of the complaint against Low.

2 The issuer of the limited partnership interests, Glickman Servicing, Inc., was a corporation owned by Glickman. It was not named as a defendant in the instant action.

(5). To comply with this provision, Associates prepared and filed a new prospectus. This new prospectus and a new flyer served as the selling documents from January 1, 1961 until February 1961, by which time all the units had been sold.

The selling documents represented, among other matters, that it was "anticipated" that distributions to partners would amount to an 11% per annum return on their investment;[3] that the two apartment houses were to be operated by Venada as net lessee and not by Associates; that Venada's net lease required it to pay to Associates an amount sufficient to cover the mortgages and taxes on the two properties, plus sufficient funds to make distributions to the partners at the anticipated rate; that Franchard had been engaged to maintain Associates' books and records and to employ independent certified accountants; and that Glickman, Siegel, and Young were officers and directors of Franchard and Venada. The selling documents also set forth the income to be received by Venada from rental of the Associates' buildings, the proposed expenses of operation, and the expected profit. The projections were made "on the basis of the rentals provided in leases already signed by tenants of Wedgwood House, the prevailing rental rates and expenses in substantially comparable buildings, the knowledge and experience of the management and engineering staff of Glickman Corporation of Nevada and other appropriate investigation and analysis." Brochure dated September 12, 1960 at 9; Prospectus dated January 1, 1961 at 11.

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3 It was disclosed that partnership distributions were to be pro-rated in proportion to original capital contributions. However, 80% of the distributions of the partnership's net cash receipts, as defined in the partnership agreement, in excess of $742,500 in any year was to be pro-rated among all partners in the same proportion, with the balance going to the general partners.

Appendix A.

Beginning January 10, 1961, distributions were paid to the partners of Associates at the rate of 11% per annum on the original capital contributed. Distributions on this basis were made monthly throughout 1961 and 1962. In January 1963, however, Venada defaulted in its obligations under the net lease. In March 1963 it was evicted.

Venada's default under the lease can be traced to events beginning in October 1960. At that time, Glickman began secretly "borrowing" Franchard's funds to cover on a short term basis his personal obligations as well as those of Venada. From October 31, 1960 to December 1960, Venada defaulted in rent payments due to three other Glickman syndications in amount of $296,329. These funds were "borrowed" from Franchard. Franchard then was repaid and a new cycle of borrowing began. Venada also would have defaulted on its first rent payment to Associates, but was able to borrow the necessary funds from Franchard.

This "borrowing" continued undiscovered until May 1962. At that time Glickman became unable to cover up the loans because, among other reasons, his holdings in various enterprises declined substantially in value. On May 3 and 4, a meeting of Franchard's board of directors was called to discuss Glickman's questionable use of Franchard's funds. Stringent limitations were imposed on Glickman to insure that he would not engage in any further "borrowing" of Franchard's funds.[4] When it was discovered in December 1962, however, that Glickman had violated his commitments to the board, he was forced to resign as an officer and director of Franchard. He thereafter also resigned as a general partner in Associates.

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4 Franchard also reported the matter to the Securities and Exchange Commission and retained Simon H. Rifkind, Esq. to study the situation and to determine whether Franchard had suffered any loss.

Appendix A.

Venada's financial condition worsened so that in February 1963 it filed a petition for an arrangement under Chapter 11 of the Bankruptcy Act. Shortly thereafter it was evicted as net lessee of Wedgwood and Warren Houses.

After Venada was evicted, Siegel and Young found a new net lessee that agreed to pay a net rental sufficient in amount to allow, after payment of total expenses, distributions at the rate of 4% per annum on the capital contributed.[5] Finally, in 1968, the properties were sold and $4,562,800 of the sale proceeds was distributed to the partners.

Going back to November 1967, appellants Cohen and Friedlander, owners of limited partnership shares in Associates, commenced this class action on behalf of all the limited partners in Associates seeking damages against Franchard, Siegel and Young, among others. The complaint set forth three separate counts. The first count alleged violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) (1970),[6] of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1970), and of Rule 10b-5, 17 C.F.R. §240.10b-5 (1972). The second count alleged violations of Section 352 of the New York General Business Law (McKinney 1968). The third count, "brought derivatively in the right of and for the benefit of Associates . . . .", alleged common law fraud.[7]

Before the case was submitted to the jury, as a result of a conference between court and counsel at the conclu-

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5 The total distribution to partners in 1961 was $707,104; in 1962, $742,500; in 1963, $225,000; in 1964, $266,600; in 1965, $266,600; in 1966, $267,500; in 1967, $268,400; and in 1968, not including proceeds from sale of the properties, $111,832.

6 Plaintiffs abandoned the claimed violations of the 1933 Act prior to submission of the case to the jury.

7 The third count was dropped by plaintiffs prior to trial. In their brief on appeal, plaintiffs do not claim error with respect to the matters alleged in the second count.

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sion of the evidence and prior to the charge, there emerged an agreement pursuant to which various allegations of misrepresentations and omissions were abandoned, thus leaving, so far as the issues on this appeal are concerned, only the allegations of paragraphs 8, 9 and 11 of the first count of the complaint (the Section 10(b) and Rule 10b-5 count). Paragraph 8 alleged certain affirmative statements made by Associates in the sales materials. Paragraph 9 alleged that these affirmative statements were false and misleading because of Associates' failure to disclose certain facts described in paragraph 9. Paragraph 11 alleged that the named plaintiffs and members of the class relied upon these false and misleading representations in purchasing partnership shares.[8]

Plaintiffs first moved for an order designating the action a class action, consisting of the 1330 purchasers of limited partnership interests, and on September 23, 1970, this motion was granted. 51 F.R.D. 167. Although the terms of Judge Tenney's order are not clear from the opinion, it appears from the latter, 51 F.R.D. at 174, that "individual issues such as 'reliance' and the quantum of damages" were to be litigated as to each purchaser, and only the issue of fraud was to be litigated as a class. As will appear in the course of this opinion, however, Judge MacMahon, whether on express consent of the parties or through their inadvertence, proceeded to put the issue of reliance before the jury in the class action.

The nine day trial began on April 27, 1972 and concluded on May 10. Only the issue of liability was tried. The court had ruled that if the jury should find in favor of plaintiffs on the issue of liability, the issue of damages would be tried immediately thereafter to the same jury.

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8 In light of the issues raised on appeal and our rulings thereon, we find it unnecessary to discuss any of the allegations of omissions and misrepresentations set forth in the complaint.

The jury returned a verdict in favor of defendants Franchard, Siegel and Young on the issue of liability.

II.

Jury Charge

Appellants' chief claim on appeal is that the jury charge was substantially incorrect in several respects with regard to what appellants were required to establish in order to recover on their Rule 10b-5 claim. Specifically, appellants contend that the court erred in charging on the legal principles of scienter and reliance, and in failing to instruct the jury that Franchard was charged with the knowledge of its agents.

Appellants did not object to the charge on these issues before the jury retired to consider its verdict as required by Fed. R. Civ. P. 51. Before we may consider the sufficiency of the charge, therefore, we must determine whether what occurred immediately prior to the charge made it unnecessary for appellants to take exceptions or, alternatively, whether we should rule on appellants' claims under the "plain error" rule.

Court's Rulings On Requests To Charge

The events regarding the court's charge to the jury may be briefly summarized. The court ordered that all requests to charge be submitted in advance of trial. This order was substantially complied with by both sides. As the trial neared completion, the court scheduled a robing room conference with counsel on May 8 to consider the requests to charge. The night before the conference, appellants left in the judge's chambers supplemental requests to charge consisting of 14 additional items. The judge did not have an opportunity to study these requests and informed counsel that he intended to reject them. Appellants' counsel as-

sured the court that he "could not and would not make any exception to the Court's charge based on these [supplemental] requests" because they were untimely.

In their timely requests to charge submitted in advance of trial, appellants requested the court to charge on the issue of scienter as follows:[9]

"PLAINTIFF'S REQUEST TO CHARGE—No. 5

Under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the defendants may be held liable to plaintiff if defendants knew or should have known that one or both of the Wedgwood prospectuses were misleading or if defendants knew of the existence of facts which, if disclosed, would have shown other facts to be misleading, . . .

PLAINTIFF'S REQUEST TO CHARGE—No. 6

You may hold the defendants liable to plaintiff and members of his class if you find defendants made false and misleading statements and omitted to state material facts about the Wedgwood House Association syndication, notwithstanding defendants' claim of ig-

9 In their requests 3 and 4 (also submitted in advance of trial) appellants referred to the issue of scienter, but in a more opaque manner:

"PLAINTIFF'S REQUEST TO CHARGE—No. 3

Plaintiff may recover against defendants participating in the acts complained of if you find that said defendants did not adhere to the special duty imposed upon them, based upon their claimed expert knowledge in syndications, not to take advantage of plaintiff's ignorance of the risks involved in the Wedgwood syndication. . . .

PLAINTIFF'S REQUEST TO CHARGE—No. 4

If you find that defendants in the sale of Wedgwood securities made false and misleading statements to plaintiff and members of his class and omitted to state material facts, you may hold the defendants liable, even if you find that defendants had an honest belief in the ultimate success of the Wedgwood venture. . . ."

> norance of the falsity of the representations if you find they could have ascertained the true facts by the exercise of the degree of care expected of a reasonably prudent person. . . ."

After a full discussion with counsel at the robing room conference, the court declined to charge on the issue of scienter in accordance with requests 5 and 6, or requests 3 and 4.

On the issue of reliance, appellants asked (in their request 19) for a charge which would have dispensed with the requirement of actual reliance. The court did not consider this request, since it was one of those submitted late. The requested charge on reliance was not even discussed at the robing room conference. The court proposed, however, to charge reliance in the language of the complaint. Counsel accepted this proposal. Accordingly, the court read to the jury as part of its charge paragraph 11 of the complaint as follows:

> "Without knowledge of the true facts and in reliance upon the false and misleading representations and statements, plaintiff and members of the class made the purchases [of limited partnership interests in Associates] hereinbefore described."

Appellants did not request the court to charge that if Bernard Mann, Franchard's treasurer, had knowledge of material misstatements or omissions, such knowledge should be imputed to Franchard under agency principles.

Following the charge, the court asked counsel if they had any exceptions. Appellants' counsel took exception to three matters, none of which have anything to do with the issues raised on appeal.[10]

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10 The three matters to which appellants' counsel excepted were: (1) a date used by the court in its recitation of the facts which counsel claimed was incorrect; (2) the court's reference to named plaintiff

Appendix A.

Reliance and Imputed Knowledge

It is clear that appellants have not preserved for appeal the claims they now seek to raise with respect to reliance and Franchard's imputed knowledge.

As to reliance, appellants argue before us that in a case of nondisclosure, as opposed to a case of affirmative misrepresentation, a plaintiff need only show that the facts withheld were material. They urge us to reverse the judgment entered on the verdict in favor of defendants on the ground that the court charged that appellants had to show actual reliance.

While appellants' request 19 did ask for a charge which keyed liability to materiality, without a requirement of actual reliance, the court properly refused to consider this request because it was not timely submitted. The charge appellants agreed to accept, based on paragraph 11 of the complaint, instructed the jury in effect that it must find actual reliance before it could return a plaintiffs' verdict. Appellants' prior acquiescence in this portion of the charge, coupled with their failure to object to it as given, precludes them from raising the issue of reliance on appeal. *United States* v. *Heyward-Robinson Co.*, 430 F.2d 1077, 1083-85 (2 Cir. 1970), *cert. denied*, 400 U.S. 1021 (1971), and cases cited at 1084; *Kane* v. *American Tankers Corp. of Delaware*, 219 F.2d 637, 640 (2 Cir. 1955); *Westmoreland Asbestos Co.* v. *Johns-Manville Corp.*, 136 F.2d 844 (2 Cir. 1943).

As to Franchard's knowledge, appellants contend that the court should have charged the jury that if they found that Bernard Mann, treasurer of both Franchard and Ve-

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Cohen's purchase in 1964 of an additional unit of limited partnership interest in Associates; and (3) whether the charge sufficiently stated that individual purchasers had signed documents claiming that they had relied on the brochure.

nada, had knowledge that certain material facts were not being disclosed to the public, such knowledge must be imputed to Franchard according to general agency principles. Since appellants totally failed to request any such instruction, either before or after the charge was given, the issue has not been preserved for appeal. *Pauling* v. *News Syndicate Co.*, 335 F.2d 659, 668-70 (2 Cir. 1964).

Scienter

Appellants' claims with respect to scienter are on a different footing. In their requests to charge submitted both in advance of trial and at the robing room conference, appellants' counsel indicated substantially the same position they now assert before us, namely, that the jury should have been instructed that defendants might be held liable if the jury found that they had negligently omitted to disclose material facts.

We hold, under the circumstances of this case, that appellants' failure to object after the court omitted from its charge an instruction on liability based on defendants' alleged negligent omissions does not preclude appellants from raising the issue on appeal. The purpose of a timely exception at the conclusion of the charge is to inform the trial judge of possible errors so that he may have an opportunity to reconsider his charge and, if necessary, to correct it. The provision of Rule 51 which requires timely exceptions is designed to prevent unnecessary new trials because of errors the judge might have corrected if they had been brought to his attention at the proper time. There is no need for an exception after the charge has been given where, as here, the court had been fully informed in advance of the charge as to appellants' contention and it was clear that further efforts to persuade the court would have been unavailing. *Steinhauser* v. *Hertz Corp.*

421 F.2d 1169, 1173 (2 Cir. 1970); *Sweeney* v. *United Feature Syndicate*, 129 F.2d 904, 905-06 (2 Cir. 1942); *Sessions* v. *Union Savings & Trust Co.*, 338 F.2d 752 (6 Cir. 1964), *cert. denied*, 382 U.S. 821 (1965). Accordingly, we hold that appellants' claims with respect to scienter have been preserved for appeal. We now turn to this issue on its merits.

Appellants' essential claim is that the court should have charged that each of the defendants might be held liable if there were material misstatements or omissions in the sales materials, even though defendants did not have knowledge of these misstatements or omissions. Appellants contend that, since Siegel and Young were promoters of the syndication, they had the opportunity and were under a duty to investigate Venada, Glickman, and any other matters which affected the investment value of Associates. Appellants also argue that Franchard, allegedly "the vortex of the syndication activity", should not be permitted to escape liability on the ground that it did not know that a fraud was being committed. In short, appellants claim that defendants should be held liable for mere negligence in allowing the dissemination of allegedly false and misleading offering materials.

The court rejected appellants' request to charge with regard to scienter on this theory. It charged in substance that, in order for appellants to recover against defendants, they had to prove actual knowledge of falsity or reckless disregard for the truth:

> "Guilty knowledge is the key to your decision in this case. The plaintiffs must establish that the defendant whom you are considering had knowledge and intended to defraud these plaintiffs, or that he acted in reckless disregard for the truth, or that he knowingly used a device, scheme, or artifice to defraud."

We uniformly have held that a party cannot be held liable in a private suit for damages under Rule 10b-5 for mere negligent conduct. See, e.g., *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, —— F.2d ——, —— (2 Cir. 1973), slip op. 4897, 4931 (March 16, 1973) (elements of Rule 10b-5 and §14(e) causes of action are the same); *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1096 n. 15 (2 Cir. 1972); *Shemtob* v. *Shearson, Hammill & Co.*, 448 F.2d 442, 445 (2 Cir. 1971). Although it is unnecessary to prove the specific fraudulent intent essential to a claim of common law fraud, it must be established that the defendant was to some extent cognizant of the misstatement or omission. *Globus* v. *Law Research Service, Inc.*, 418 F.2d 1276, 1290-91 (2 Cir. 1969), *cert. denied*, 397 U.S. 913 (1970); *Heit* v. *Weitzen*, 402 F.2d 909, 913-14 (2 Cir. 1968), *cert. denied*, 395 U.S. 903 (1969).[11] The standard for determining liability under Rule 10b-5 essentially is whether plaintiff has established that defendant either knew the material facts that were misstated or omitted and should have realized their significance, or failed or refused to ascertain and disclose such facts when they were readily available to him and he had reasonable grounds to believe that they existed. See *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp., supra*, —— F.2d at ——, slip op. at 4932-33. It is not enough for plaintiff to show that defendant failed to detect certain material facts when he had no reason to suspect their existence.

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11 See ALI, Federal Securities Code, §251A, Tentative Draft No. 2 (March 1973), which reads as follows:

"Sec. 251A. [Knowledge.] When reference is made to this section, a misrepresentation is known by a person to be a misrepresentation if he (a) knows or believes that the matter is otherwise than represented, (b) does not have the confidence in its existence or nonexistence that he expresses or implies, or (c) knows that he does not have the basis that he states or implies he has for his belief."

Appendix A.

Appellants urge that we adopt a standard that failure to discover material facts when such facts could have been ascertained without inordinate effort is enough to establish a private action under Rule 10b-5, "particularly where fiduciary relationships require attention". We decline the invitation.

Accordingly, since the court in substance charged actual knowledge of falsity or reckless disregard for the truth—in language that conveyed the essence of the standard stated above—we hold that its charge on scienter was essentially correct.

Plain Error

But this does not end our inquiry. Our Court and other courts of appeals have recognized an exception to the rule that, absent objection in the district court, an appellate court necessarily is precluded from considering alleged errors in the jury charge. An appellate court on its own initiative may reverse on the ground of plain error in a jury charge that was not objected to when such reversal is necessary to correct a "fundamental error" or to prevent a "miscarriage of justice." *Curko* v. *William Spencer & Son Corp.*, 294 F.2d 410, 413-14 (2 Cir. 1961); *Delancey* v. *Motichek Towing Serv., Inc.*, 427 F.2d 897, 901 (5 Cir. 1970); *Ramsey* v. *Travelers Ins. Co.*, 317 F.2d 300, 302 (4 Cir. 1963). Upon our own initiative, therefore, we turn to the question whether the judgment entered on the jury verdict below should be reversed on the ground that the court's charge on reliance and its failure to charge on Franchard's imputed knowledge were "plain error".

With regard to the issue of reliance, the court charged that appellants could recover only if they could prove that "the omitted fact must have been a substantial factor in plaintiff making a choice as to whether or not to buy."

While this "actual reliance" standard finds support in our opinion in *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (2 Cir.), *cert. denied*, 382 U.S. 811 (1965), we are aware that in two recent Supreme Court decisions involving fraudulent nondisclosure it was held that proof of actual reliance was not essential to a claim for damages.[12] It therefore is arguable that the court erred with respect to this portion of its charge, and that it should have charged that the knowledge which Mann, the treasurer of Franchard and Venada, had of Venada's distressed financial situation should have been imputed to Franchard. *Dawn Donut Co.* v. *Hart's Food Stores*, 267 F.2d 358, 363 (2 Cir. 1959).

After careful review of the entire record, however, we are convinced that these alleged errors do not warrant our invoking the plain error rule. In our view, appellants' claims do not demonstrate that a substantial miscarriage of justice has occurred. Granted that the alleged errors relate to important elements in appellants' case, we do not believe that the plain error rule demands that

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12 In *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 385 (1970) (Section 14(a)), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-54 (1972) (Rule 10b-5), the Supreme Court held that, under the circumstances of those two cases, it was unnecessary to prove actual reliance. It was enough that there were material misrepresentations in solicitation documents which were "an essential link in the accomplishment of the transaction." 396 U.S. at 385. The full implications of those decisions have not yet been determined. See *Chris-Craft Industries, Inc.* v. *Piper Aircraft Co., supra*, —— F.2d at ——, slip op. at 4951-59; *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 796 (2 Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 288-91 (3 Cir.), *cert. denied*, 409 U.S. 874 (1972). We decline to hold on the present state of the law that it was plain error for the district court in the instant case not to have instructed the jury according to the *Mills* and *Ute* formulations.

We also note that several commentators have questioned the application of the *List* standard in nondisclosure cases. See 6 Loss, Securities Regulation 3879 (2d ed. 1969); 1 Bromberg, Securities Law: Fraud—SEC Rule 10b-5, at 212 (1969); Note, Civil Liability Under Section 10(b) and Rule 10b-5: A Suggestion for Replacing the Doctrine of Privity, 75 Yale L.J. 658, 688 (1965).

every alleged error, even on a significant aspect of a case, requires reversal despite failure to comply with Rule 51. *Troupe* v. *Chicago, Duluth & Georgian Bay Transit Co.*, 234 F.2d 253, 260 n. 10 (2 Cir. 1956). See *Nimrod* v. *Sylvester*, 369 F.2d 870, 873 (1 Cir. 1966). Intervention by us to correct such questionable errors under the plain error doctrine would undercut the salutary rule that claims must be raised in and ruled upon by the trial court before they are ripe for appellate review. As Professors Wright and Miller have stated, "[i]f there is to be a plain error exception to Rule 51 at all, it should be confined to the exceptional case where the error has seriously affected the fairness, integrity, or public reputation of judicial proceedings." 9 Wright & Miller, Federal Practice and Procedure §2558, at 675 (1971).

Appellants also assert that "[t]he Court ignored the fact that this was a class action and there were other buyers involved as well." As indicated above, it is possible that the terms of the order designating the class eliminated, pursuant to Fed. R. Civ. P. 23(c)(4), the issue of reliance for determination as to the entire class. However, the judge clearly proceeded on the assumption that the issue of reliance was to be decided with the issue of liability, and the record is utterly devoid of any objection or contrary suggestion by trial counsel for appellants.

We hold upon the entire record that this is not an appropriate case for exercising our discretionary power to review errors not preserved by proper objection in the trial court.

III.

Conduct of Trial

Appellants' claims regarding the trial judge's conduct of the trial merit only brief mention.

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Essentially appellants have engaged in a broadside attack upon the judge's rulings on evidence, oral and documentary; his comments to the jury; the "unevenness" of his rulings in favor of defendants; and his creation of prejudice in favor of defendants.

Suffice it to say that our careful examination of the entire trial transcript of this nine day trial leaves us with the firm conviction that appellants' claims of misconduct on the part of the judge are wholly without merit.

In the first place, the conduct complained of was far from unprovoked. The alleged improper acts strike us as appropriate responses by a conscientious judge in handling difficult situations created largely by the lack of preparation for trial and evasive attitude toward the judge by appellants' counsel.

Secondly, our scrutiny of the record discloses that in every instance complained of the judge was doing his very best to clarify the issues and assist the jury in understanding the evidence in a case which, but for the judge's intervention, could have baffled even the most conscientious jury.

Finally, we do not find a single instance of conduct on the part of the judge which in any way prejudiced appellants or displayed the slightest bias toward them.

In short, we hold that there is no merit whatsoever in appellants' claims of misconduct on the part of the trial judge, for we can say with fair assurance, "after pondering all that happened without stripping the erroneous action from the whole, that the judgment was not substantially swayed by the error . . . ." *Kotteakos* v. *United States*, 328 U.S. 750, 765 (1946); *United States* v. *McCarthy*, —— F.2d ——, —— (2 Cir. 1972), slip op. 4847, 4862 (December 8, 1972); *United States* v. *Ellis*, 461 F.2d 962, 970 (2 Cir. 1972).

Affirmed.

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In their first claim, plaintiffs allege that each defendant violated the anti-fraud provisions of the federal securities laws. Plaintiffs claim that in the connection with the offer and sal of limited partnership units of Wedgwood House Associates to plaintiffs and to other members of the class the defendants directly or indirectly, alone and in concert, by use of means or instrumentalities of interstate commerce and of the mails, employed devices, schemes and artifices to defraud, made untrue statements of material facts and omitted to state federal facts which were necessary in in order to make the statements made in light of the circumstances under which they were made, not misleading, and engaged in acts, practices, and a course of conduct

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which would and did operate as fraud and deceit upon plaintiffs and other members of the class.

Plaintiffs claim that they have suffered a loss because they bought their units without knowledge of the true facts and in reliance upon false and misleading representations and statements made by defendants in the brochures and prospectuses used in connection with the offer to sell the units to the public.

Now, the mere fact that this real estate venture went sour and failed to succeed does not in itself entitle these plaintiffs to recover from these defendants, nor does it make these defendants or any of them liable to the plaintiffs. None of us can predict the future with absolute certitude. All investments, therefore, involve the risk of loss.

As the brochure in this case itself stated in plain English: "All statements, projections and material contained herein which relate to future transactions or happenings are, of course, subject to and contingent upon presently unforeseeable developments."

Defendants cannot be charged with fraud simply because they may have failed, honestly failed, forecast the future correctly. They have no magic crystal ball. Their actions are to be judged not

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hindsight but by what they knew and believed at the time these units were being offered for sale to the public.

Fraud is a serious charge. It is never presumed. On the contrary, the law assumes that men act honestly and in good faith in their dealings with each other. Having made the claim that they were defrauded, and cheated, plaintiffs have the burden of convincing you from the evidence that the facts essential to prove their claim are more likely so than not so.

Now, the federal law upon which this first claim is based provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange, A, to employ any device, scheme or artifice to defraud; B, to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made in light of the circumstances under which they were made not misleading; or C, to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security."

Now, a scheme to defraud is any plan by which one seeks to obtain money or property from another by

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means of false, deceptive or misleading statements
material facts. Plaintiffs claim that the repre
tions which damaged them were contained in two bro
and two prospectuses issued in connection with the
and sale of limited partnership units in Wedgwood
Plaintiffs claim that those documents contain stat
which were untrue and were also misleading because
they fail to mention certain facts.

According to plaintiffs' complaint, th
were many untrue statements and many omissions of
material facts.

• • • • • •

THE COURT: B/ I want to caution you that
our system of law anybody can claim anything they wa
against anybody else, that he is entitled to come in
court, but when he comes here, the burden is upon hi
prove what he claims, for the mere fact that he clai
it is no proof whatever that what he says is true.

In order to prove their claim of fraud,

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irst claim, under the Federal Securities Laws, the laintiff must prove each of the following facts by a air preponderance of the evidence:

1. That the defendant used or participated n the use of hte brochure and prospectuses through the ails or telephone in connection with the offer or sale f limited partnership units in Wedgwood House Associates nd that the mails or telephones were used for that urpose.

2. That the brochures and prospectuses so sed did contain untrue statements of fact or did omit o state facts necessary in order to make the statements hich were made not misleading in light of the circum- tances.

3. That the untrue statements or omitted facts were material.

4. That the defendant either knew that the tatements made were untrue or knew of the existence of mitted facts which if disclosed would have shown that he statements made were misleading.

5. That the plaintiffs relied on the untrue r misleading statement of fact.

We will now discuss the first element that the

defendant used or participated in the use of brochures and prospectuses in connection with the offer or sale of units through the mails or telephone.

There is no dispute in the evidence that the documents were sent through the mails and that the telephones were used, so you really have nothing to decide on that problem. Likewise, there is no dispute that Siegel and Young did assemble data and participate in the preparation and use of the documents in connection with the offer or sale of the units. There is a sharp dispute, however, as to whether Franchard Corporation, a public Corporation, had anything whatever to do with the brochures or prospectuses or with the offer to sell units in Wedgwood House Associates.

Franchard Corporation contends that its only connection with this venture was to perform supervisory management services on behalf of the partnership, such as keeping the books, records and files and preparing and mailing distribution checks and periodic reports to the unit holders for an annual fee of $10,000. You may not return a verdict against Franchard Corporation on this first claim unless you first find that it either engaged in some conduct in connection with the sale or offer to sell units of limited partnership in Wedgwood House

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associates or that Franchard Corporation knew at the time the brochures and prospectuses were used not only that they contained misrepresentations of material facts or omitted to state material facts, but also that Franchard Corporation had knowledge that others had combined to use such documents to perpetrate a fraud on buyers of Wedgwood House Associates, and knowing that fact, participated in a concerted prearranged, unlawful plan to use those documents, or that Franchard Corporation knowing that others were perpetrating a fraud, voluntarily took an active part in promoting or facilitating the commission of the fraud with knowledge of the unlawful conduct; in other words, that Franchard Corporation consciously associated, knowingly and consciously associated itself with a fraudulent scheme with the intent that its conduct aided in its success.

Franchard Corporation is liable to the plaintiffs if you find that it knowingly associated and combined with others or aided or helped others or participated with others in the planning or commission of a fraud.

The second element is that the defendant made untrue or misleading statements of fact. Misrepresentations are usually made in two ways: First, by false

statements of fact. In other words, just plain lies. And second, by omitting or by not telling facts which are necessary to make a statement truthful.

In other words, when one makes a statement of fact, he is under a duty not to lie about it or to give such a distorted picture or such a confusing version of the statement is misleading concerning the true and the real facts. Sometimes a half truth is no better than an outright lie.

And fraudulent misrepresentations may be made by half truths if they are calculated to mislead. Having chosen to speak, there is an obligation to tell the facts which are necessary to convey a true and a fair understanding of the subject matter. This is especially so when parties stand in a fiduciary relationship as the general partners in this syndicate did to the limited partners.

The general partners cannot take advantage of a disparity of knowledge which they have over the limited partners. Such a relationship requires that the general partners deal with the limited partners in the utmost good faith, and that they make a full and fair disclosure of all material facts known to them at the time.

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A statement, although literally true, can be
lse nevertheless, if when considered in light of all the
rcumstances, it would deceive, mislead or create a
lse impression of the true state of affairs on the minds
those intended to be influenced by the statement.

Defendants claim that the brochures and pros-
ctuses used here did not contain any untrue statements
d did not omit any fact that was necessary to make the
atements which were made not misleading. They contend
at the facts claimed to be omitted were either altogether
n-existent at the time of these brochures, or if they
d exist, that none of these defendants knew about them.
u must determine whether plaintiffs have established
at the statements made in the Wedgwood House selling
cuments, the brochures and prospectuses, whether they
re untrue or misleading in the light of all the
rcumstances existing.

The circumstances existing at that time, not
ter the discovery of Glickman's manipulations and
pplins of funds which was made in 1962, but in late
60 and early 1961 when the Wedgwood House units were
ing sold. In short, you cannot judge these
fendants with 20-20 hindsight.

The third element is that the untrue statements

or the omitted facts were material. By material I m
an untrue statement of fact which could reasonably be
expected to influence a person to decide whether or n
to act, and in this case, whether or not to buy a li
partnership interest in Wedgwood House Associates.
Similarly, an omission is material if the unrevealed
would influence an investor's decision on whether or
buy a unit in Wedgwood House.

The fourth fact that plaintiffs must prov
by a fair preponderance of the evidence is that each
defendant knew at the time a statement was made in th
selling documents that such statement was either fals
misleading with respect to a material fact or that th
selling documents omitted to state a material fact wh
was necessary to make the statement not false or misl
I misspoke there. I said he had to show that each
defendant made it. He has to show that the defendan
whom you are considering made it. Each defendant m
be judged separately.

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Guilty knowledge is the key to your decision in this case. The plaintiffs must establish that the defendant whom you are considering had knowledge and intended to defraud these plaintiffs, or that he acted in reckless disregard for the truth, or that he knowingly used a device, scheme or artifice to defraud. There is a sharp dispute about that in this case.

Knowledge is the key in this case, and knowledge, what goes on in a man's mind, is something that you can only tell by the way he behaves, by what he says, by what he does, and by his conduct in the transactions involved here.

The plaintiff has offered no direct evidence that Siegel or Young knew that any facts contained in the brochure or prospectus were untrue or misleading. Rather, plaintiffs ask you to rely on circumstantial evidence and to draw an inference or a conclusion that they did know that material statements made in the brochures and prospectuses were untrue or misleading.

Plaintiff points to the circumstance that both had a long association with Glickman; that they were officers and directors of Glickman Corporation which later became Franchard Corporation, and also of Glickman of Nevada, the net tenant; that they were general partners

of Wedgwood House Associates, and that their names ap
on many of the documents introduced in evidence in th

Against this, both Siegel and Young testifi
they did not know that the selling documents containe
untrue statement of fact or omitted to state any mate
fact necessary to make the statements which were made
misleading. Rather, they contend and they say that
were betrayed by Glickman; that he duped them; that t
the victims, not the beneficiaries of this fraud.

Louis Glickman, you will recall, testified
he never told them about any of his manipulations, an
did not know, he said, about the bum checks and the c
in the drawer. Both Siegel and Young testified that
were in effect employees, mere underlings, whatever t
titles, and that they did not know about Glickman's fi
problems or his manipulation of corporate funds.

On the contrary, they both testified that t
believed from their long association, as others did,
Glickman was a multimillionaire during the period of
that the Wedgwood units were being sold. Glickman s
to us here in this courtroom that he was indeed a mul
millionaire at that time.

Both Siegel and Young testified that they di
learn of Glickman's financial problems or of his manip

lations or his fraud until May of 1962, long after the Wedgwood units had all been sold, and that when they learned of it they severed their relationship with him; that Glickman was ousted from the corporation, and that they made every effort they could to set matters in order.

It is for you to decide, on the basis of all the evidence and circumstances as you recall, whether any of the defendants had guilty knowledge that any of the material statements of fact contained in the selling documents were untrue or misleading.

Now turning to the final element that the plaintiff must establish, and that is that the plaintiffs relied on untrue or misstatements of material facts, the test for determining whether or not a plaintiff relied on an alleged misrepresentation or an omission is whether the misrepresentation or omitted fact was a substantial factor in plaintiff making a choice as to whether or not to buy a limited partnership unit in Wedgwood House Associates, or whether the plaintiff acted because of some other reason.

You should ask yourself, how many of these prospective buyers actually read the documents? Did they rely on the statements?

In order to be influenced by the representation, the plaintiff must, of course, have relied upon it, must

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have read it, he must relied upon it and he must have believed it to be true. If it appears that he knew facts or that he believed the statements to be false, or that he reposed no confidence in it, the false stat cannot be regarded as a substantial cause in making hi decision whether or not to buy a unit. The represen must have had a material influence upon the plaintiff' action and be a substantial factor in bringing about w he does.

In this connection you will recall that ther some evidence to the effect that the plaintiff here, Raphael Cohen, purchased units in Wedgwood House long the facts underlying the complaints made here became g knowledge, and were fully exposed, and you should cons that fact along with the other evidence as to whether plaintiffs relied on any statements contained in the h and the prospectuses.

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